Statement of
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U.S. Department of Housing and Urban Development
November 3, 1999
Before the Subcommittee on Criminal Justice, Drug Policy and Human Resources
U.S. House of Representatives

Management and Marketing Contracts for Real Estate Owned Activities

Chairman Mica, Ranking Member Mink, and other Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the Management and Marketing (M&M) Contracts for HUD's property disposition activities. On September 17, 1999, our Southeast/ Caribbean District issued a comprehensive audit of HUD property disposition activities titled: "Nationwide Internal Audit of Federal Housing Administration's (FHA) Single-Family Property Disposition Program". When we began this review, plans for contracting out property disposition activities were still under discussion. By the end of our audit, the M&M contracts had been awarded but not yet started.

I want to make it clear that we have not audited the current Management and Marketing (M&M) Contracts. At the time of our property disposition audit, HUD had more than 350 contracts nationwide with Real Estate Asset Mangers (REAMs). The M&M concept was an effort to move to fewer and larger contracts that would require less contract monitoring staff. We have been tracking the progress of the property disposition contracting efforts through periodic management reports and discussions with program staff. We made a conscious decision to hold-off on any detailed audit work until M&M contractors had sufficient time to get up to speed. We believe that sufficient time has elapsed and we will begin our audit later this month.

We did have an opportunity to review the M&M contracts and the contract monitoring policies towards the end of our property disposition audit. We also looked at the M&M contracts in a separate review of Departmental Procurement earlier this year. I'll comment on both audits in a moment, but first let me give some background on the property disposition program. The following information is from HUD's Single Family Acquired Asset Management System. During fiscal year 1999, HUD sold about 62,000 properties and about 51,000 properties remain in inventory at year end. For Fiscal Year 1999, HUD's average acquisition cost was $85,934. It took an average of 201 days to sell each property. The average sales price was $63,791 and all the costs incurred between acquisition and sale averaged $9,749. The average loss on each property was $31,892.

During our property disposition review, property inventories increased by 71% from 24,800 properties at the end of fiscal year 1996 to 42,300 properties at the end of our audit period in February 1999. Much of this growth was attributable to an overwhelmed HUD staff. We found that staff shortages, inexperienced staff, a growing workload, and limited travel funds prevented program staff from effectively overseeing their activities. Further complicating the problem was FHA's expectations that the M&M contracts would be operational by October 1998. These problems were costly to the Department. FHA's goals to sell properties at 98% of appraised value in an average of 150 days were not being met. If FHA had attained these goals, the insurance fund would have taken in an additional $269 million in Fiscal Years 1997 through 1998.

I might add, the current inventory has grown to 51,516 properties at the end of September 1999. Much of this jump in inventory is attributable to the inability of one contractor, Intown Properties, to promptly list and sell properties. As you know, Intown's contract was terminated in September 1999. Intown was awarded 7 of the 16 M&M contracts. These seven contracts accounted for approximately 40% of the property disposition workload. Most of Intown's workload was turned over to other M&M contractors and in two locations, to HUD staff.

Our property disposition audit noted that while the M&M contracts and contract monitoring policies were comprehensive, there were some areas in need of improvement. Contracts did not contain (1) sufficient information regarding FHA's reimbursement to contractors for property repair costs, or (2) monetary penalties for contractor noncompliance. In addition, the new contract monitoring manual did not provide comprehensive guidance to review and approve reimbursement of repair costs, conduct contract risk assessments, and document monitoring results. Clarity and consistency in applying policy is needed to prevent contractor noncompliance and abuse.

Our recent "Internal Audit Follow-up Review of HUD Contracting", dated September 30, 1999, examined the contract actions leading up to the M&M awards. The Department carried out this procurement action without conducting an OMB Circular A-76 cost comparison to determine if contracting out was warranted. While these M&M contracts were anticipated to cost $927 million over the next five years, the Department believed that a cost comparison was not legally required. We disagreed. The Supplement to Circular A-76 states that the Circular is not designed to simply contract out, rather, it is designed to balance the interests of the parties in a make or buy cost comparison; provide a level playing field between public and private offerors to competition; and encourage competition and choice in the management and performance of commercial activities.

The Department stated that there is no requirement to conduct an A-76 review if the contract is not affecting more than 10 HUD employees. Additionally, it said that it is the program office's responsibility to evaluate all of the procurement alternatives, and the contracting office's responsibility to ensure that once the procurement decision is made that the award is carried out efficiently. We believe the Office of Procurement and Contracts needs to be involved much earlier in the contract process.

We reviewed the implementation and pre-award files for the M&M contracts. Prior to the awards, these functions were handled by a combination of HUD staff and REAM contractors nationwide. Even though these procurements have five year spending authority of approximately $1 billion and the contractors have substantial control of HUD's multi-billion dollar single family inventory, the Office of Housing did not adequately document or evaluate basic business decisions before executing these contracts. Instead of preparing an A-76 cost study, Housing requested a determination from the Chief Financial Officer (CFO) that a study was not technically required. The memorandum did not explain Housing's intent to contract out the entire process at a cost of about $200 million annually. The CFO agreed with Housing that, since the Department was not reducing staff, the study was not required. This rationale is particularly questionable given all the downsizing and restructuring that had been and was being considered by the Department.

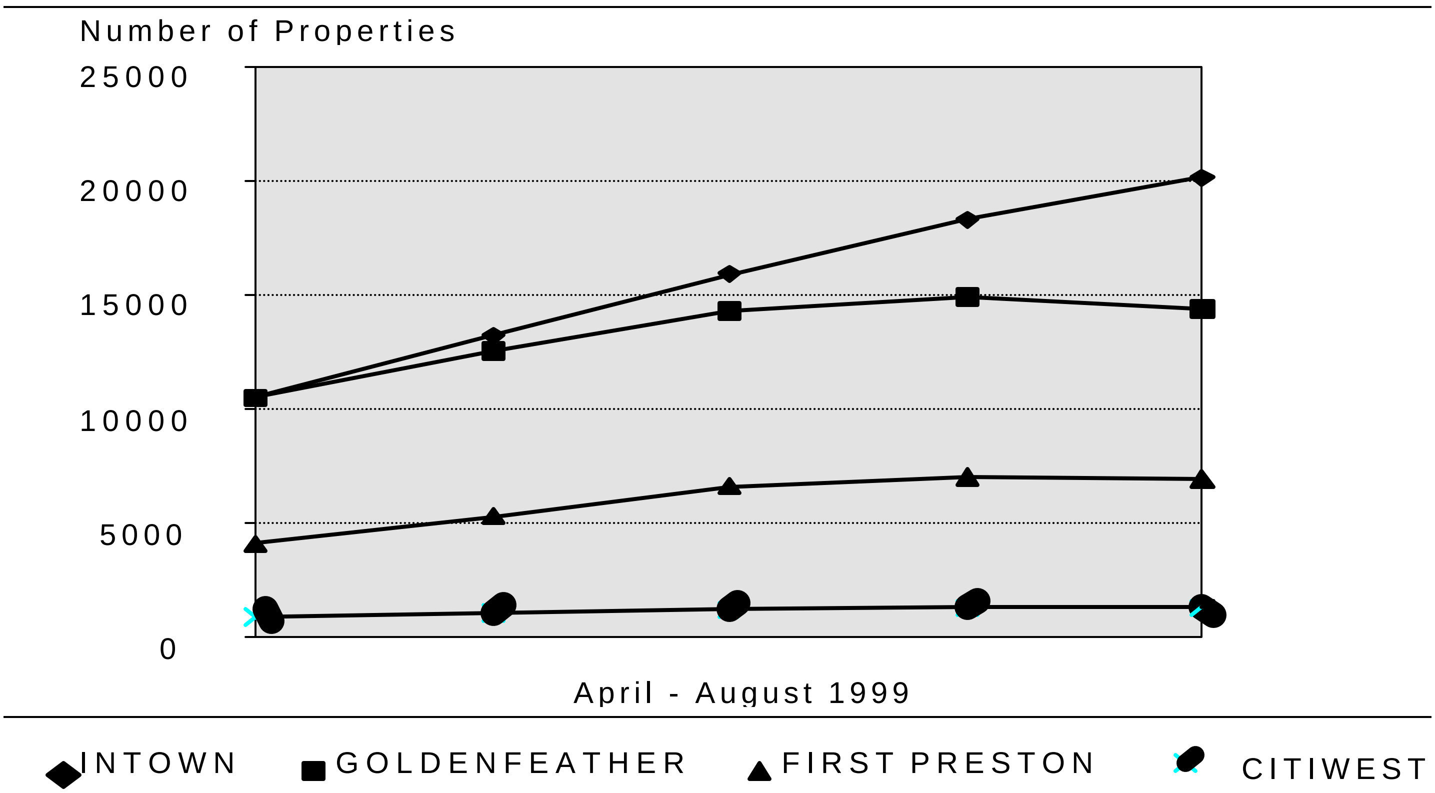
The National Academy of Public Administration, which recently complimented HUD for its procurement reforms, stated "HUD must have performance standards and operating principles for the new model procurement system that are based on sound business principles and replicate best practices in government agencies and private sector firms." We believe the decision not to conduct an A-76 study is contrary to these principles.

In addition to the absence of a cost analysis for the M&M procurement, we questioned the Department's examination of the financial and operational capacity of bidders. Intown Management Group was awarded contracts comprising 40% of HUD's work, making Intown one of the largest property managers in the country. We asked contracting staff if they considered Intown's financial capacity to manage such a large contract. We reviewed the summary of negotiations and technical evaluation reports and did not see a discussion of capacity. The staff indicated these matters were discussed and it was determined that Intown had sufficient financing to manage these contracts.

During negotiations Intown reduced its original bids from $565.5 million to $367 million, a 30 percent drop. Revised best pricing schedules provided by Intown during the negotiation process may have been overly ambitious, as they did not account for any cost increases over the five year life of the contract, which included employee costs. In fact, Intown's estimated costs would actually decrease due to improved efficiency and reduced overhead and profit. HUD Contract staff stated that Intown had the highest technically rated proposal, and believed the negotiation process evidenced HUD's interest in procuring the best value.

Our analysis of acquired property inventory reports from the Single Family Acquired Management System showed that there was a large increase in property inventories during the first four months of the M&M contract. While all of the contractors seemed to be having performance difficulties, Intown's lack of performance stood out from other large contractors.

	April Inventory	August Inventory	Inventory Increase (%)
Intown	**10,540**	**20,150**	**91%**
Goldenfeather	10,542	14,370	36%
First Preston	4,082	6,911	69%
Citiwest	871	1,324	52%
Totals	26,035	42,755	64%



When we completed our fieldwork in August 1999, Intown had sold only 2.8 percent of its assigned inventory. M&M contractors receive 30 percent of their fees when properties are listed and the remaining 70 percent when they are sold. Consequently, there was a concern that Intown would not be able to adequately maintain the 20,000 HUD properties assigned to them without the revenues generated from property sales.

On September 23, 1999, HUD announced it had terminated Management and Marketing contracts with Intown Management Group. I recently read a news article which quoted an Intown employee as saying that the Government had "unsound and insane expectations" of this contract and that it was designed to fail. We hope those contractors remaining can manage this large workload. We anticipate a report from our upcoming audit in about six months and we will be happy to keep you apprised of our findings.